



# Chapter 9: Payment and Collection





## **CHAPTER 9**

### **PAYMENT AND COLLECTION**

I. INTRODUCTION .....	1
A. Objectives.....	1
B. Perspective .....	1
II. REFERENCES.....	1
III. POLICIES AND PROCEDURES .....	2
A. FAR Part 32 .....	2
B. Disbursing Authority.....	2
C. Contract Payments.....	2
D. Advances .....	3
E. Invoice Payments vs. Financing Payments .....	3
F. Order of Preference.....	4
G. Payment Requirements .....	4
H. Invoice Payment Due Date .....	4
I. Financing Payment Due Date .....	5
IV. CONTRACT PAYMENT METHODS .....	5
A. Definitions.....	5
B. Non-Commercial Contract Payments.....	5
C. Commercial Item Purchase Payments.....	13
D. Progress Payments on Construction Contracts .....	16
V. THE PROMPT PAYMENT ACT .....	16
A. Applicability of the Prompt Payment Act (PPA).....	16
B. Invoice Payment Procedures .....	19
C. Fixed-Price Construction Contracts .....	24

D. Fixed-Price Architect-Engineer Contracts .....	25
E. Prompt Payment Discounts .....	25
F. Waiver.....	26
VI. ELECTRONIC FUNDS TRANSFERS (EFT) .....	26
A. Mandatory Use .....	26
B. Specified Payment Date .....	27
C. Assignment of Claims .....	28
D. DOD’s Central Contractor Registration (CCR) .....	28
E. Incorrect EFT Information .....	28
F. Payment by Government Purchase Card .....	28
G. FAR Clauses .....	28
H. Liability for Erroneous Transfers.....	28
VII. ASSIGNMENT OF CLAIMS .....	30
A. General Rule. ....	30
B. Protection for the Assignee .....	31
VIII. DEBT DETERMINATION AND COLLECTION PROCEDURES. ....	32
A. Debts Covered by Contract Collection Procedures.....	32
B. Determination of Contractor Debt.....	33
C. Enforcing Government Claims-Collecting the Debt. ....	35
D. Compromise Actions.....	35
E. Funds Received from the Contractor.....	37
IX. CONCLUSION.....	37

## **CHAPTER 9**

### **PAYMENT AND COLLECTION**

#### **I. INTRODUCTION.**

- A. Objectives. Following this block of instruction, students should understand these concepts:
  - 1. The various methods used by the Government to pay contractors.
  - 2. The methods, and order of preference, for financing Government contracts.
  - 3. The application of “The Prompt Payment Act.”
  - 4. The Government’s policies and procedures for identifying and collecting contract debts.
- B. Perspective. “The Department [of Defense] continues to experience an unacceptable number of contract payment problems. These problems are caused by a number of factors including systems deficiencies and contract structure.”<sup>1</sup>

#### **II. REFERENCES.**

- A. 10 U.S.C. § 2307, Contract Financing.
- B. 31 U.S.C. § 3901, Prompt Payment.
- C. 31 U.S.C. § 3701, Claims.

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<sup>1</sup> Memorandum, The Under Secretary of Defense, Acquisition and Technology, to Assistant Secretaries of the Military Departments, subject: Reducing Contract Fund Citations (30 Apr. 1999).

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- D. 31 U.S.C. § 3727 and 41 U.S.C. § 15, Assignment of Claims Act of 1940.
- E. 41 U.S.C. § 255, Advance or other payments.
- F. Federal Acquisition Regulation, Part 32, Contract Financing.
- G. DoD Financial Management Regulation (DoD 7000.14-R), vol. 10, Contract Payment Policy and Procedures.
- H. 5 CFR Part 1315, "Prompt Payment."

### **III. POLICIES AND PROCEDURES.**

- A. FAR Part 32. This Part prescribes policies and procedures for contract financing and other payment matters.
- B. Disbursing Authority.
  - 1. The Financial Management Service (FMS), a bureau of the U.S. Department of the Treasury, is the principle disbursing agent of the Federal government, accounting for approximately 85% of all Federal payments.
  - 2. The Department of Defense, the United States Marshal's Office, and the Department of Transportation (with respect to public money available for the Coast Guard's expenditure when it is not operating as a service in the Navy) have statutory authority to disburse public money. 31 U.S.C. § 3321.
- C. Contract Payments. All solicitations and contracts shall specify the payment procedures, payment due dates, and interest penalties for late invoice payment. FAR 32.903(a). There are two major types of government contract payments:
  - 1. Payment of the contract price for completed work.
  - 2. Payment in advance of work performance.

D. Advances. An advance of public money may be made only if authorized by Congress or the President. 31 U.S.C. § 3324(b).

E. Invoice Payments vs. Financing Payments. FAR Subpart 32.9.

1. Invoice payments are payments made upon delivery of goods or performance of services and acceptance by the government. Invoice payments include:

a. Final payments of the contract price, costs, or fee in accordance with the contract or as settled by the government and the contractor.

b. Payments for partial deliveries or partial performance under fixed-price contracts.

c. Progress payments:

(1) Construction contracts.

(2) Architect/Engineer contracts.

2. Financing payments are made to a contractor before acceptance of goods or services by the government. Such payments include:

a. Advance payments.

b. Progress payments based on costs.

c. Progress payments based on a percentage or stage of completion.<sup>2</sup>

d. Interim payments on cost-type contracts.

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<sup>2</sup> Progress payments under fixed-price construction and fixed-price architect-engineer contracts are treated as invoice payments under the Prompt Payment Act.

- F. Order of Preference. FAR 32.106 provides the following order of preference when a contractor requests contract financing, unless an exception would be in the Government's interest in a specific case:
1. Private financing without Government guarantee (note, however, that the intent is not to require private financing at unreasonable terms or from other agencies);
  2. Customary contract financing (see FAR 32.113);
  3. Loan guarantees;
  4. Unusual contract financing (see FAR 32.114); and
  5. Advance payments (see exceptions at FAR 32.402(b)).
- G. Payment Requirements. Payments are based on receipt of a proper invoice or contract financing request, and satisfactory contract performance. FAR 32.903(c).
- H. Invoice Payment Due Date. The due date for making an invoice payment is prescribed in FAR 32.905. Government acceptance of supplies or services or receipt by the designated billing office of a proper invoice, whichever is later, triggers the time period for calculation of prompt payment. Failure of the Government to pay the contractor by the due date results in payment of interest.



- I. **Financing Payment Due Date.** The due date for making a contract financing payment is prescribed in FAR 32.906. Generally, the due date for contract financing payments is 30 days from date of receipt by the designated billing office of a proper payment request. Failure of the Government to make a contract financing payment by the due date does not normally entitle the contractor to interest.<sup>3</sup> However, late payment can be a defense to a default termination. However, see Jones Oil Company, ASBCA No. 42651, 98-1 BCA ¶ 29,691 (contractor will succeed in appealing a default termination of a contract only if the late payment rendered appellant financially incapable of continuing performance, was the primary or controlling cause of the default, or was a material rather than insubstantial or immaterial breach).

**IV. CONTRACT PAYMENT METHODS.** 41 U.S.C. § 255; 10 U.S.C. § 2307; FAR Part 32. FAR Part 32 draws a distinction between contract payments for commercial items and noncommercial items.

A. **Definitions.**

1. Commercial items are defined at FAR 2.101. For example, a computer qualifies as a commercial item because it is sold to the general public.
2. A non-commercial item is a supply or service that is not available for sale to the public, such as a major weapon system.

B. **Non-Commercial Contract Payments.** Payment methods for non-commercial item supplies or services include partial payments, advance payments, progress payments, loan guarantees, provisional delivery payments, and performance-based payments.

1. **Partial Payments.**

- a. Partial payments are payments made under fixed-price contracts for supplies or services that are accepted by the government but are only part of the contract requirements. FAR 32.102(d).

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<sup>3</sup> FAR 32.904(e) establishes a due date for interim payments on cost-reimbursement contracts for services 30 days after the date of receipt of a proper invoice.

- b. Although partial payments are generally treated as a method of payment and not as a method of contract financing, using partial payments can help contractors participate in government contracts without, or with minimal, contract financing. When appropriate, agencies shall use this payment method. FAR 32.102(d).
- c. FAR 52.232-1 provides that unless otherwise specified in the contract, the government must make payment under fixed-price contracts when it accepts partial deliveries if:
  - (1) The amount due on the deliveries warrants it; or
  - (2) The contractor requests payment and the amount due on partial deliveries is at least \$1,000 or 50% of the total contract price.

2. Advance Payments. FAR Subpart 32.4; FAR 52.232-12, Advance Payments.

- a. Advance payments are advances of money by the government to a prime contractor before, in anticipation of, and for the purpose of complete performance under one or more contracts. They are expected to be liquidated from payments due to the contractor incident to performance of the contract. Advance payments may be made to a prime contractor for the purpose of making advances to subcontractors.
- b. This is the least preferred method of contract financing.
- c. Requirements. FAR 32.402(c).
  - (1) The contractor must give adequate security.
  - (2) Advance payments cannot exceed the unpaid contract price.
  - (3) The agency head or designee must determine that advance payment is in the public interest or facilitates the national defense.

- d. According to FAR 32.402(c)(2), the agency head or designee<sup>4</sup> must make written findings that:
  - (1) Advance payment will not exceed the contractor's interim cash needs.
  - (2) Advance payment is necessary to supplement other funds or credit available to a contractor.
  - (3) The recipient is otherwise qualified as a responsible contractor.
  - (4) The government will benefit.
  - (5) The case fits one or more of the categories described in FAR 32.403.
- e. Advance payments can be authorized in addition to progress or partial payments on the same contract.
- f. Advance payments may be appropriate for the following (FAR 32.403):
  - (1) Contracts for experimental, research or development projects with nonprofit education or research institutions.
  - (2) Contracts solely for management and operation of Government-owned plants.
  - (3) Contracts of such highly classified nature that assignment of claim is undesirable for national security reasons.

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<sup>4</sup>For the Army, the designee is the Assistant Secretary of the Army (Financial Management), *see* AFARS 32.402. The Air Force designee is the Assistant for Accounting and Banking, Office of the Assistant Secretary of the Air Force (Financial Management and Comptroller) (SAF/FMPB), *see* AFFARS 5332.409.

- (4) Contracts with financially weak contractors with essential technical ability. In such a case, contractor performance shall be closely monitored to reduce Government's financial risk.
  - (5) Contracts for which a loan by a private financial institution is not practicable.
  - (6) Contracts with small business concerns.
  - (7) Contracts where exceptional circumstances make advance payments the most advantageous contract financing method for both the contractor and the Government.
- 3. Progress Payments. There are two types of progress payments: those based on costs incurred and those based on the stage of completion of the contracted work.
  - a. Costs Incurred. Progress payments can be made on the basis of costs incurred by the contractor as work progresses under the contract. FAR Subpart 32.5; FAR 52.232-16, Progress Payments.
    - (1) Unless otherwise provided for in agency regulations, the contracting officer shall not provide for progress payments to a large business if the contract amount is less than \$2 million or to a small business if the contract amount is less than the simplified acquisition threshold (currently \$100,000). FAR 32.104(d)(2)-(3).
    - (2) Subject to the dollar thresholds, a contracting officer may provide for progress payments if the contractor must expend money during the predelivery period that will have a "significant impact" on its working capital, and there is a substantial time from contract inception to delivery (six months for a large business and four months for a small business). FAR 32.104(d)(1).

- (3) As part of a request for progress payments, a contractor may include the full amount paid to subcontractors as progress payments under the contract and subcontracts. FAR 32.504(b).
- (4) Progress payments made under indefinite-delivery contracts should be administered under each individual order as if the order constituted a separate contract, unless agency procedures provide otherwise. FAR 32.503-5(c) (as amended by FAC 97-16). But see Aydin Corp. v. Widnall, 61 F.3d 1571 (Fed. Cir. 1995) (contractor entitled to administrative and production costs incurred to implement cost segregation requirements imposed by the contracting officer, where DFARS clause provided for progress payments based on cumulative total costs of the contract).
- (5) Progress payments can be added to the contract after award by contract modification, but the contractor must provide adequate consideration. FAR 32.005.
- (6) Customary progress payments. FAR 32.501-1 and FAR 32.502-1.
  - (a) The FAR provides that the customary amount is 80% for large businesses and 85% for small businesses. FAR 32.501-1(a).
  - (b) DFARS provides for a customary uniform progress payment rate of 80% for large business, 90% for small business, and 95% for small, disadvantaged businesses. DFARS 232.501-1(a)(i).<sup>5</sup>

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<sup>5</sup> DoD issued a proposed rule change on August 24, 2001 increasing the customary progress payment rate for large businesses to 80%. The payment rate change is applicable only to contracts awarded on or after October 1, 2001.

(7) Unusual progress payments. Unusual contract financing is financing with additional approval requirements. FAR 32.001.

(a) Contracting officer may provide unusual progress payments only if (FAR 52.501-2):

- (i) Contract necessitates predelivery expenditures that are large in relation to the contractor's working capital and credit;
- (ii) Contractor fully documents an actual need to supplement private financing available;
- (iii) Contractor's request is approved by the head of the contracting activity or designee.

(b) DoD requires advance approval of the USD(A&T)DP for any "unusual" progress payment requests. DFARS 232.501-2.

b. Percentage or Stage of Contract Completion. Progress payments also can be based on a percentage or stage of contract completion, if authorized by agency procedures. Use of this type of progress payment is subject to the following restrictions:

- (1) DFARS 232.102 provides that these types of progress payments are only authorized for construction contracts, shipbuilding, and ship conversion, alteration or repair.
- (2) The agency must ensure that payments are commensurate with the work accomplished. Greenhut Constr. Co., ASBCA No. 41777, 93-1 BCA ¶ 25,374 (after hurricane damaged previously completed construction work, Navy was entitled to review the work and pay only the amount representing satisfactorily completed work).
- (3) Under undefinitized contract actions, such payments cannot exceed 80% of the eligible costs of work accomplished.

4. Loan Guarantees.

- a. FAR Subpart 32.3 prescribes policies and procedures for designated agencies' guarantees of loans made by private financial institutions to borrowers performing contracts related to national defense.
- b. The use of guaranteed loans requires the availability of certain congressional authority. DoD has not requested authority in recent years, and none is now available. DFARS 232.302.

5. Provisional Delivery Payments. DFARS 232.102-70.

- a. The contracting officer may establish provisional delivery payments to pay contractors for the costs of supplies and services delivered to and accepted by the government under the following contract actions, if undefinitized:
  - (1) Letter contracts contemplating a fixed-price contract,
  - (2) Orders under basic ordering agreements,
  - (3) Unpriced equitable adjustments on fixed-price contracts, and
  - (4) Orders under indefinite delivery contracts.
- b. Provisional delivery payments shall be used sparingly, priced conservatively, and reduced by liquidating previous progress payments in accordance with the Progress Payments Clause.
- c. Provisional delivery payments shall not include profit, exceed funds obligated for the undefinitized contract action, or influence the definitized contract price.

6. Performance-Based Payments.<sup>6</sup> Performance-based payments are the preferred financing method when the contracting officer finds its use practical and the contractor agrees to its use. FAR 32.1001(a).

- a. Performance-based payments may be made either on a whole contract or on a deliverable item basis, unless otherwise prescribed by agency regulations. FAR 32.1004.
  - (1) Financing payments made on a whole contract basis apply to the entire contract.
  - (2) Financing payments made on a deliverable item basis apply to a specific deliverable item.
- b. Performance-based payments may not exceed 90 percent of the contract price if on a whole contract basis, or 90 percent of the delivery item price if on a delivery item basis. FAR 32.1004(b)(2).
- c. The payments may be made on any of the following bases (FAR 32.1002):
  - (1) Performance measured by objective, quantifiable methods;
  - (2) Accomplishment of defined events; or
  - (3) Other quantifiable measures of results.
- d. The contracting officer may use performance-based payments only when the contracting officer and the offeror agree on the performance-based payment terms, the contract is a definitized fixed-price type contract, and the contract does not provide for other methods of contract financing, except for advance payments or loan guarantees. FAR 32.1003.

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<sup>6</sup> The Defense Contract Management Agency website at [www.dcmc.hq.dla.mil](http://www.dcmc.hq.dla.mil) provides guidance on the use and administration of performance-based payments (PBPs).



e. FAR 32.1000 provides that performance-based payments are not used in the following instances:

- (1) Payments under cost-reimbursement contracts.
- (2) Contracts for architect-engineer services or construction, or for shipbuilding or ship conversion, alteration, or repair, when the contracts provide for progress payments based on a percentage or stage of completion.

C. Commercial Item Purchase Payments. 10 U.S.C. § 2307(f); 41 U.S.C. § 255(f); FAR 32.2.

1. General Rule. Although financing of the contract is normally the contractor's responsibility, in some markets, the provision of financing by the buyer is a commercial practice. The contracting officer may include appropriate financing terms in contracts for commercial purchases when it is in the best interests of the government.

2. Types of Payments. FAR 32.202-2:

a. Commercial advance payment.

- (1) Payments made before any performance of work.
- (2) Limited to 15% of contract price.
- (3) Not subject to Prompt Payment Act interest.
- (4) Payment is made on contract specified date, or 30 days after receipt by the designated billing office of a proper request for payment, whichever is later. DFARS 232.206(f)(i).

b. Commercial interim payment.

- (1) Not commercial advance payment or delivery payment.

- (2) Payments made after some work has been done.
- (3) Late payment is not subject to Prompt Payment Act interest penalty.
- (4) Payment is made on entitlement date specified in the contract, or 14 days from the receipt by the designated billing office of a proper request for payment, whichever is later. DFARS 232.206(f)(ii).

c. Delivery payment.

- (1) Payment for accepted supplies or services.
- (2) Includes partial deliveries.
- (3) Considered an invoice payment subject to Prompt Payment Act interest.
- (4) The prompt payment standards for commercial delivery payments are the same as specified in FAR Subpart 32.9.

d. Installment payment financing for commercial items shall not be used for defense contracts unless market research has established that this form of contract financing is both appropriate and customary in the marketplace. DFARS 232.206(g).

3. Prerequisites. FAR 32.202-1. Commercial item purchase financing, consisting of either interim payments or advance payments, may be made under the following circumstances:

- a. The item financed is a commercial supply or service.
- b. The contract price exceeds the simplified acquisition threshold.

- c. The contracting officer determines that it is appropriate/customary in the commercial marketplace to make financing payments for the item.
- d. This form of contract financing is in the best interest of the government. To help make this determination, the FAR authorizes agencies to establish standards, such as type of procurement, type of item, or dollar level. FAR 32.202-1(e).
- e. Adequate security is obtained from the contractor. FAR 32.202-4.
  - (1) Subject to agency regulations, the contracting officer may determine the offeror's financial condition to be adequate security provided the offeror agrees to provide additional security should that financial condition become inadequate as security. DFARS 232.202-4 states that an offeror's financial condition may be sufficient to make the contractor responsible for award purposes, but not be adequate security for commercial contract financing.
  - (2) Types of Security.
    - (a) Paramount lien.
    - (b) Irrevocable letters of credit.
    - (c) Surety bond.
    - (d) Guarantee of repayment from a person or corporation of demonstrated liquid net worth connected by significant ownership to the contractor.
    - (e) Title to identified contractor assets of adequate worth.

- (3) The value of the security must be at least equal to the maximum unliquidated amount of contract financing payments to be made to the contractor. The value of security may be adjusted during contract performance as long as it is always equal to or greater than the amount of unliquidated financing. FAR 32.202-4(a)(3).

D. Progress Payments on Construction Contracts. FAR 32.103; FAR 52.232-5, Payments Under Fixed-Price Construction Contracts.

1. When a construction contract provides for progress payments and the contractor fails to achieve satisfactory performance for a period for which a progress payment is to be paid, the government may retain a percentage of the progress payment. The retainage shall not exceed 10 percent of the progress payment.
2. Entitlement to progress payments requires compliance with the contract and relevant regulations. The Davis Group, Inc., ASBCA No. 48431, 95-2 BCA ¶ 27,702.

V. **THE PROMPT PAYMENT ACT.** 31 U.S.C. § 3901-3907; 5 C.F.R. 1315;<sup>7</sup> FAR Subpart 32.9.

A. Applicability of the Prompt Payment Act (PPA).

1. Background.
  - a. Prior to enactment of the Prompt Payment Act of 1982, the Federal government did not have uniform criteria for establishing due dates for payments to contractors.

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<sup>7</sup> OMB Circular A-125 has been rescinded and replaced by the Prompt Pay regulations at 5 CFR Part 1315.

- b. Many invoices were paid too early or too late. The General Accounting Office (GAO) estimated that contractors were losing at least \$150 million annually due to late payments, and the Federal Government could save at least \$900 million annually if payments that had been paid early had instead been paid when due.<sup>8</sup>
- c. To address these concerns, the PPA and implementing guidance and regulations issued by the Office of Management and Budget (OMB) provided for payment due dates and interest penalties for late payments.
- d. The PPA provides that interest begins when the government fails to make timely payments to the contractor after receipt of a proper invoice from the contractor.

2. Coverage.

- a. The PPA applies to all government contracts except for contracts where payment terms and late payment penalties have been established by other governmental authority (e.g., tariffs). FAR 32.901. See Prompt Payment Act Interest on Utility Bills, B-214479, Sept. 22, 1986, 1986 U.S. Comp. Gen. LEXIS 497. See also National Park Service—Late Payment Charges for Utility Services, B-222944, Oct. 23, 1987, 1987 U.S. Comp. Gen. LEXIS 316 (holding that elements of implied contract governed payment terms with private, unregulated utility company)
- b. The PPA applies to all government agencies.
- c. There are no geographical limitations to applicability of the PPA's procedural requirements. FAR 32.901. Ingenieurgesellschaft Fuer Technische Dienste, ASBCA No. 42029, 42030, 94-1 BCA ¶ 26,569.

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<sup>8</sup> Actions to Improve Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars, (AFMD-82-1, Oct. 1, 1981).

3. In analyzing whether the contractor is entitled to PPA interest, the government must determine that:
  - a. the PPA applies to the payment,
  - b. the invoice is proper,
  - c. the government has accepted the supplies or services, and
  - d. the government has paid the invoice late.
4. **Applicability to Types of Payments.** The PPA applies to invoice payments i.e., payments made for supplies or services accepted by the government. For purposes of applying the PPA, invoice payments include (FAR 32.902):
  - a. Payment for supplies or services accepted by the Government.
  - b. Payments for partial deliveries accepted by the Government under fixed-price contracts.
  - c. Final cost or fee payments where the Government and the contractor have settled the amounts owed.
  - d. Progress payments under fixed-price architect-engineer contracts.
  - e. Progress payments under fixed-price construction contracts.
  - f. Interim payments on cost-reimbursement service contracts.<sup>9</sup>

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<sup>9</sup> FAR 32.907 imposes an interest penalty on interim payments on cost-reimbursement contracts for services, when such payment is made more than 30 days after the designated billing office receives a proper invoice. 66 Fed. Reg. 65,359 (Dec. 18, 2001). Section 1007 of the National Defense Appropriations Act for FY 02 also requires payment of Prompt Payment Act interest for these late payments.

5. The PPA does not apply to contract financing payments made prior to acceptance of supplies or services. FAR 32.902. For purposes of applying the PPA, contract financing payments include (FAR 32.902):
  - a. Advance payments.
  - b. Progress payments based on cost.
  - c. Progress payments based on percentage or stage of completion (except for those made under the fixed-price construction and fixed-price architect-engineer payments clauses noted above).
6. The PPA does not require payment of interest when payment is not made because of a dispute over the amount of payment due or compliance with the contract. Active Fire Sprinkler Corp. v General Servs. Admin., 2001 GSBFA LEXIS 172 (July 11, 2001).

B. Invoice Payment Procedures.

1. Proper invoice required. The contractor must submit a proper invoice to trigger the PPA. FAR 32.903(h). Invoice means a contractor's bill or written request for payment under the contract for supplies delivered or services performed. FAR 32.902.
  - a. Under FAR 32.905(e), a proper invoice must include:
    - (1) Name and address of contractor.
    - (2) Invoice date.
    - (3) Contract number or other authorization.
    - (4) Description, quantity, unit of measure, and cost of supplies delivered or services performed.
    - (5) Shipping and payment terms.

- (6) Name and address of contractor official to whom payment is to be sent.
  - (7) Name, telephone number, and mailing address of person to notify if the invoice is defective.
  - (8) Any other information or documentation required by the contract, such as evidence of shipment.
  - (9) Though not required, contractors are strongly encouraged to assign an identification number to each invoice.
- b. Notice of defective invoice. The government must notify the contractor of any defective invoice within 7 days (3 days for meat, meat food products, and fish; 5 days for perishable agricultural commodities, dairy, and edible fats or oils) after receipt of the invoice at the designated payment office. The notice should include a statement identifying the defect in the invoice. FAR 32.905(e).
- (1) If such notice is not timely, an adjusted due date for purposes of determining an interest penalty will be established in accordance with FAR 32.907-1(b).
  - (2) FAR 32.907-1(b)(2) provides that the due date on the corrected invoice will be adjusted by subtracting from it the number of days taken beyond the prescribed notification of defects period.
  - (3) The contractor will not be entitled to PPA interest for late payment, despite the agency's failure to notify the contractor of a defective invoice, if the contractor knew that its invoice was defective. Masco, Inc., HUDBCA No. 95-G-147-C16, 96-2 BCA ¶ 28364 (contractor knew that invoiced work had not yet been completed).



- c. Supporting documentation is required. FAR 32.905(f).
  - (1) A receiving report or some other government document authorizing payment must support all invoice payments. A receiving report is evidence that the government accepted the supplies delivered or services performed by the contractor.
  - (2) The agency receiving official must forward supporting documentation by the 5th working day after government acceptance or approval, unless the parties have made other arrangements. This period of time does not extend the payment due date.
- 2. Payment due date. FAR 32.905(a) provides the payment due date for invoice payments, not including architect-engineer, construction, or food and specified item contracts, is the later of:
  - a. The 30th day after the designated billing office receives a proper invoice; or
  - b. The 30th day after government acceptance of supplies delivered or services performed by the contractor.
    - (1) On a final invoice where the payment amount is subject to contract settlement actions, acceptance occurs on the effective date of the settlement.
    - (2) For the sole purpose of computing an interest penalty, government acceptance occurs constructively on the 7<sup>th</sup> day after the contractor has delivered the supplies or performed the services, unless there is a disagreement over quantity, quality, or contractor compliance with a contract requirement.

- (3) Except for commercial items as defined in FAR 2.101, the contracting officer may specify a longer period for constructive acceptance. This is normally to afford the government a reasonable opportunity to inspect and test the supplies furnished or to evaluate the services performed, but cannot be used as a routine agency practice. The contract file must indicate the justification for extending the constructive acceptance period beyond 7 days.
- c. Special payment periods. The payment due date on contracts for perishable agricultural commodities is shorter. (meat, 7 days; fish, 7 days; perishable agricultural commodities, 10 days; dairy, 10 days; etc.) FAR 32.905(d).
  - d. It is DOD policy to assist small disadvantaged businesses by paying them as quickly as possible after receipt of a proper invoice, and before normal payment due dates in the contract. This policy does not alter the payment due date for purposes of the Prompt Payment Act. DFARS 232.903.
- 3. Interest penalty for late payment. The government incurs an interest penalty for late invoice payment, including late payment of progress payments under fixed-price architect-engineering contracts and fixed-price construction contracts. FAR 32.907-1. Under the new interim final rule, interest penalties also accrue for late payment of interim payments on cost-reimbursement service contracts.<sup>10</sup>
  - a. Accrual. The interest penalty accrues when the government pays the contractor after the contract payment due date. Interest penalties will not accrue for more than one year. FAR 32.207-1(e).
  - b. Automatic payment. The interest penalty accrues automatically and must be paid by the government without request by the contractor. The government must pay any interest penalty of \$1 or more.<sup>11</sup> FAR 32.907-1(e).

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<sup>10</sup> See 65 Fed. Reg. 78,403 (Dec. 15, 2000) for interim final rule.

<sup>11</sup> The Defense Finance and Accounting Service (DFAS) has expressed concern that the costs of making such small payments may not justify the payments. In FY 1996, DFAS Columbus made 10,789 interest payments—about one quarter of all interest payments--totaling \$28,701. DFAS regulations require documentation of the reason for the

c. The interest penalty is not excused by temporary unavailability of funds. FAR 32.903(h).

d. Late payment penalty upon interest penalty.

(1) The contractor is entitled to a penalty payment if the contractor is owed an interest penalty of \$1 or more, the agency fails to make a required interest penalty payment within 10 days after the date the invoice amount is paid, and the contractor makes a written demand for the penalty within 40 days after the payment. FAR 32.907-1(g)(1).

(2) The penalty upon penalty amount is 100% of the interest penalty owed the contractor, not to exceed \$5,000, nor be less than \$25. FAR 32.907-1(g)(3).

4. Contract Disputes Act Interest Distinguished from Prompt Payment Act Interest.

a. Under the CDA, the government pays interest on amounts found to be due to a contractor on claims submitted to the contracting officer. Such CDA interest accrues from the date the contracting officer receives a proper claim until payment of the amount due on the claim. 41 U.S.C. § 611. See Paragon Energy Corp., ENG BCA No. 5302, 91-3 BCA ¶ 24,349 (payment of CDA claim presumed to include interest).

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late payment, and in one case a \$1.05 payment was supported with nine pages of documentation. Financial Management: The Prompt Payment Act and DOD Problem Disbursements (GAO/AIMD-97-71, May 23, 1997).

- b. PPA and CDA interest is based on the rate established by the Secretary of the Treasury and published in the Federal Register. 31 U.S.C. § 3902 and 41 U.S.C. § 611.<sup>12</sup> Under the CDA, the government pays simple interest and adjusts the rate every six months in accordance with the current Treasury rate. In contrast, PPA interest is compounded and is not adjusted during the one year accrual period.
- c. If a contractor files a claim under the CDA for PPA interest, interest will run under the PPA until government receipt of the claim, after which CDA interest will apply. Technocratica, ASBCA No. 44444, 94-1 BCA ¶ 26,584.

C. Fixed-Price Construction Contracts.

- 1. The government must pay interest on approved construction contract progress payments that remain unpaid for more than 14 days after the designated billing office receives a proper payment request. FAR 32.905(c)(i).
- 2. Similarly, the contractor must pay interest on unearned progress payments, e.g., when the contractor's performance for which progress payments are made does not conform to contract terms. FAR 52.232-5(d), Payments under Fixed-Price Construction Contracts. The government must demand payment of the underlying debt in a sum certain. Electronic & Space Corp., ASBCA No. 47539, 95-2 BCA ¶ 27,768 (the government's letter which simply stated "it appears" progress payments were overpaid was ruled to be an improper demand letter).
- 3. The government must pay interest on any retained amount that is approved for release if the government does not pay the retained amount to the contractor by the 30th day (unless specified otherwise in contract) after release. FAR 32.905(c)(ii).

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<sup>12</sup> Information concerning the interest rate can be obtained through the Federal Register or from the Department of the Treasury, Financial Management Service (FMS), Washington, DC 20227 (202) 874-6995. The rate applicable from 1 January 2002 to 30 June 2002 is 5.50%. The FMS website is <[www.fms.treas.gov](http://www.fms.treas.gov)>.

4. Interest penalties are not required on payment delays due to disagreement between the parties over the payment amount or other issues involving contract compliance. Claims involving disputes and any interest thereon will be resolved in accordance with the Disputes clause. FAR 52.232-27 (a)(4)(iv).
- D. Fixed-Price Architect-Engineer Contracts. The government must pay interest penalties on approved contract progress payments that remain unpaid for more than 30 days after government approval of contractor estimates of work or services accomplished. FAR 52.232-10, Payments Under Fixed-Price Architect-Engineer Contracts; FAR 52.232-26, Prompt Payment for Fixed-Price Architect-Engineer Contracts.
- E. Prompt Payment Discounts.
1. Discount for prompt payment means an invoice payment reduction voluntarily offered by the contractor, in conjunction with the clause at FAR 52.232-8, Discounts for Prompt Payment, if payment is made by the government prior to the due date. The due date is calculated from the date of the contractor's invoice. If the contractor has not placed a date on the invoice, the due date is calculated from the date the designated billing office receives a proper invoice, provided the agency annotates such invoice with the date of receipt at the time of receipt. When the discount date falls on a Saturday, Sunday, or legal holiday when federal government offices are closed and government business is not expected to be conducted, payment may be made on the following business day and a discount may be taken.
  2. The government may take prompt payment discounts offered by a contractor only when it makes payment within the specified discount period.<sup>13</sup>
  3. The PPA imposes an interest penalty on improperly taken discounts, and the agency must pay the penalty without request by the contractor. FAR 32.907-1(c).

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<sup>13</sup> For a discussion on the propriety of taking a prompt payment discount for progress payments made in the normal course of contract administration, See Prompt Payment Discounts Based on Progress Payments, ARMY LAW., Aug. 1994, at 54.

4. The government policy provisions at FAR 32.903 state that the government shall not make invoice and contract financing payments earlier than 7 days prior to the dates specified in the contract unless the agency head, or designee, determines to make earlier payment on a case-by-case basis.
- F. Waiver. A contractor may waive an interest penalty payment issued to it under the PPA either by an express written statement or by acts and conduct which indicate an intent to waive. Central Intelligence Agency - Waiver of Interest Under Prompt Payment Act, 62 Comp. Gen. 673 (1983) (contractor refused to accept interest check prepared by agency).

## **VI. ELECTRONIC FUNDS TRANSFERS (EFT). FAR Subpart 32.11.**

- A. Mandatory Use. Payment by EFT is the mandatory method of contract payment<sup>14</sup> in normal contracting situations except for the following situations listed in FAR 32.1103:
1. The office making payment under a contract requiring EFT loses the ability to release payment by EFT. In such a case, the paying office shall make all the necessary payments by check or some other mutually acceptable method of payment. FAR 32.1103(a).
  2. The payment will be received by or on behalf of a contractor outside the United States and Puerto Rico. FAR 32.1103(b). However the agency head may authorize EFT for a non-domestic transaction if the political, financial, and communications infrastructure in the foreign country supports EFT payment. FAR 32.1106(b)(1).
  3. The payment will be paid in other than US currency. FAR 32.1103(c). However, the agency head may authorize EFT if such a transaction may be made safely. FAR 32.1106(b)(2).

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<sup>14</sup> 31 USC §3332 requires use of EFT in all situations except when recipients certify in writing that they do not have an account with a financial institution.

4. Classified contracts, where EFT payments could compromise the safeguarding of classified information or national security, or where arrangements for appropriate EFT payments would be impractical due to security considerations. FAR 32.1103(d).
5. Contracts executed by deployed contracting officers in the course of military operations, including but not limited to, contingency operations as defined in 10 U.S.C. § 101(a)(13), or a contract awarded during emergency operations, such as natural disasters or national or civil emergencies.
6. The agency does not expect to make more than one payment to the same recipient within a one year period. FAR 32.1103(f).
7. The agency's need for supplies and services is of such unusual and compelling urgency that the government would be seriously injured unless payment is by a method other than EFT. FAR 32.1103(g).
8. There is only one source for supplies and services and the government would be seriously injured unless payment is by a method other than EFT. FAR 32.1103(h).
9. Payment by a method other than EFT is otherwise authorized by the Department of Treasury Regulations at 31 CFR 208. FAR 32.1103(i).

B. Specified Payment Date. FAR 32.902.

1. The date on which the funds are to be transferred to the contractor's account by the financial agent according to agency's EFT payment transaction instruction given to the Federal Reserve System.
2. If no date has been specified in the instruction, the specified payment date is 3 business days after the payment office releases the EFT payment transaction instruction.

- C. Assignment of Claims. Using EFT payment methods is not a substitute for a properly executed assignment of claims. EFT information showing the ultimate recipient of the transfer to be other than the contractor, in the absence of a proper assignment of claims, is considered to be incorrect EFT information. FAR 32.1105.
- D. DOD's Central Contractor Registration (CCR).
  - 1. Contractors provide EFT data to DOD by registering in the CCR. Registration is mandatory prior to award of a contract, basic agreement, basic ordering agreement, or blanket purchase agreement.
  - 2. Exceptions to this policy: DFARS 204-7302.
    - a. Purchases made with the Government-wide commercial purchase card,
    - b. Awards made to foreign vendors for work performed outside the United States,
    - c. Classified contracts or purchases,
    - d. Contracts awarded by deployed contracting officers, and
    - e. Purchases to support unusual or compelling needs.
- E. Incorrect EFT Information. If the contractor's EFT information is incorrect, the Government need not make payment until the contractor supplies the correct information. Any invoice submitted under the contract is deemed not to be a proper invoice for purposes of prompt payment. FAR 52.232-33(d); FAR 52.232-34(c).



- F. Payment by Government Purchase Card.<sup>15</sup> The financial institution that issued the government credit card may make immediate payment to the contractor. The government will reimburse the financial institution. FAR 32.1108.<sup>16</sup>
- G. FAR Clauses: Unless payment will be made exclusively through the government purchase card, other third party arrangement, or pursuant to an exception in FAR 32.1103, the contracting officer shall insert the clause at FAR 52.232-33, Payment by Electronic Funds Transfer-Central Contractor Registration, in all solicitations where the paying office uses the Central Contractor Registration database as its source of EFT information. In contracts where clause 52.232-33 is not inserted, the contracting officer will insert the clause at FAR 52.232-34, Payment by Electronic Funds Transfer-Other than Central Contractor Information.
- H. Liability for Erroneous Transfer
1. If an uncompleted or erroneous transfer occurs because the government failed to use the contractor provided EFT information in the correct manner, the government remains responsible for making a correct payment, paying any prompt penalty due, and recovering any erroneously directed funds. FAR 52.232-33(f)(1).
  2. If an uncompleted or erroneous transfer occurs because the contractor provided incorrect EFT information, and if the funds are no longer in the control of the payment office, the government is deemed to have made payment and the contractor is solely responsible for recovery of any of the erroneously directed funds. If the funds remain under the control of the payment office, the government retains the right to either make payment by mail or suspend the payment. FAR 52.232-33(f)(2).

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<sup>15</sup> DOD requires use of the purchase card as payment for any purchase at or below the micro-purchase threshold (\$2,500). A written determination by a Senior Executive Service member, Flag Officer, or General Officer is required in certain instances where the card is not used. Memorandum, The Under Secretary of Defense, Acquisition and Technology, to Secretaries of the Military Departments, subject: Streamlined Payment Practices for Awards/Orders Valued at or below the Micro-Purchase Threshold (2 Oct. 1998).

<sup>16</sup> Written contracts to be paid by purchase card should include the clause at 52.232-36, Payment by Third Party, as prescribed by FAR 32.1110(d). However, payment by a purchase card also may be made under a contract that does not contain the clause if the contractor agrees to accept the card as a method of payment. FAR 32.1108(b).

3. Prompt Payment Act. A payment shall be deemed to have been made in a timely manner if the EFT payment transaction instructions given to the Federal Reserve System specifies the date for settlement of the payment on or before the prompt payment due date, whether or not the Federal Reserve System actually makes the payment by that date. FAR 32.903(k).

## **VII. ASSIGNMENT OF CLAIMS.**

- A. General Rule. A contractor may assign its right to be paid by the government for contract performance. FAR 32.802.

1. Under the Assignment of Claims Act (31 U.S.C. § 3727) and Assignment of Contracts Act (41 U.S.C. § 15), a contractor may assign monies due or to become due under a contract if all of the following conditions are met:

- a. The contract specifies payments aggregating \$1,000 or more.
- b. The contractor makes the assignment to a bank, trust company, or other financing institution, including any federal lending agency.
- c. The contract does not prohibit the assignment.
- d. Unless the contract expressly permits otherwise, the assignment:
  - (1) Covers all unpaid amounts payable under the contract;
  - (2) Is made only to one party; and
  - (3) Is not subject to further assignment.
- e. The assignee sends a written notice of assignment together with a true copy of the assignment instrument to the:
  - (1) Contracting officer or agency head,

- (2) Surety on any bond applicable to the contract; and
- (3) Disbursing officer designated in the contract to make payment.

2. The provisions of the Assignment of Claims Act are construed strictly. See Summerfield Housing Limited Partnership v. United States, 42 Fed. Cl. 160 (1998).

B. Protection for the Assignee. 41 U.S.C. § 15; FAR 32.804.

1. Once the assignee notifies the government of the assignment, the government must pay the assignee. Payment to the contractor will not discharge the government's obligation to pay the assignee. Tuftco Corp. v. United States, 222 Ct. Cl. 277 (1980).
2. The government cannot recover payments made to the assignee based on the contractor's liability to the government. FAR 32.804.
3. DOD may include a "no-setoff" provision in its contracts upon a determination of need by the President published in the Federal Register. 41 U.S.C. § 15(e). Formerly, agencies could only use a "no-setoff" provision upon a Presidential proclamation of war or national emergency. This authority has been delegated to the Head of the Agency after such determination has been published in the Federal Register. Use of the "no-setoff" provision may be appropriate to facilitate the national defense, in the event of a national emergency or natural disaster, or when the use of a "no-setoff" provision may facilitate private financing of contract performance. If the offeror is significantly indebted to the Government, this information should be used in the determination. FAR 32.803(d).

4. If the contract contains a no-setoff commitment clause (FAR 52.232-23, Alt I), the assignee will receive contract payments free of reduction or setoff for:
  - a. Any liability of the contractor arising independent of the contract. FAR 32.804(b)(1). See Bank of Amer. Nat. Trust and Sav. Ass'n v. United States, 23 F.3d 380 (Fed. Cir. 1994) (SBA loans to fund contract performance are “independent” of the contract and not subject to set-off). See also Applied Companies v. United States, 37 Fed. Cl. 749 (1997) (discussing use of no-setoff provision by assignor).
  - b. Certain liabilities arising under the same contract, such as fines, penalties, and withheld taxes (FAR 32.804(b)(2)).

## **VIII. DEBT DETERMINATION AND COLLECTION PROCEDURES.**

### **A. Debts Covered by Contract Collection Procedures. FAR 32.602.**

1. Damages or excess costs arising from a contractor's default in performance.
2. Breaches of contract obligations by the contractor concerning progress payments, advance payments, or government-furnished property or material.
3. Expenses incurred by the government in correcting defects.
4. Government overpayment to contractors due to billing errors, such as stating an incorrect quantity, or deficiencies in quality or erroneous payments made through EFT.<sup>17</sup>

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<sup>17</sup> The General Accounting Office (GAO) has issued numerous reports highlighting DOD's problems concerning overpayments to contractors. In fiscal years 1994 through 1998, defense contractors returned \$4.6 billion to the Defense Finance and Accounting Center in Columbus, Ohio, due to overpayments resulting from contract administration actions and payment processing errors. See DOD Procurement: Funds Returned by Defense Contractors (GAO/NSIAD-98-46R, Oct. 28, 1997), and DOD Procurement: Millions in Overpayments Returned by DOD Contractors (GAO/NSIAD-94-106, Mar. 14, 1994).

5. Retroactive price reductions resulting from contract terms for price redetermination or for determination of prices under incentive-type contracts.
6. Delinquency in contractor payments due to the government under agreements for deferral or postponement of collections.
7. Reimbursement of costs as provided in FAR 33.102(b) and 33.104(h)(1), paid by the Government where a postaward protest is sustained as a result of an awardee's misstatement, misrepresentation, or miscertification.

B. Determination of Contractor Debt.

1. Overpayment problem. Contractor reconciliation of its billings to government accounting and payment data is a key procedure for identifying government overpayments.<sup>18</sup>
2. Cooperation among government officials. The FAR requires contracting officers, contract financing offices, disbursing officials, and auditors to cooperate fully with each other to properly identify and promptly collect contract debts. FAR 32.605(a).
3. Responsibility.
  - a. Normally, the contracting officer has primary responsibility for determining the amount of a debt and for collecting it. FAR 32.605(b).
  - b. For DOD agencies, the disbursing officer is responsible for determining the amount and collecting contract debts whenever the government makes overpayment or erroneous payments. DFARS 232.605(b).

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<sup>18</sup> See DOD Contract Management: Greater Attention Needed to Identify and Recover Overpayments (GAO/NSIAD-99-131, July 19, 1997). On March 8, 2000 the House of Representatives passed a bill (H.R. 1827) aimed at helping federal agencies recover overpayments to contractors. The bill would mandate audits of certain accounts, and allow for recovered money to be split between the federal treasury and the agency. The Senate's version (S. 3030) would require recovery auditing to help agencies identify discrepancies between the amount owed and the actual amount paid. Both bills are awaiting final action.

4. Procedures.

a. The responsible official determines the substantive basis for the government's entitlement. FAR 32.606.

(1) Contractual. Identify the specific contract provision(s) upon which the government's claim is based. Common bases include:

(a) Defective Pricing. See FAR 15.407-1, Defective Cost or Pricing Data.

(b) Excess Costs of Reprocurement. See FAR 49.402-6, Repurchase Against Contractor's Account.

(c) Recovery of Unliquidated Progress Payments. See FAR 52.232-16(h).

(d) Recovery of Unliquidated Advance Payments. See FAR 52.232-12; Do-Well Machine Shop Inc., ASBCA Nos. 34565, 40895, 99-1 BCA ¶ 30,320 (SBA entitled to unliquidated advance payment following default termination of 8(a) contractor); Johnson Mgmt. Group CFC Inc., HUDBCA Nos. 96-C-132-C15, 97-C-109-C2, 1999 HUD BCA LEXIS 7 (HUD had paramount lien on start-up equipment purchased with advance payments).

(2) Other bases for government entitlement include common law (e.g., breach of contract, consequential damages) and debts from other contracts.

b. The responsible official must issue a demand letter notifying the contractor of the debt as soon as the responsible official has computed the amount of refund due. FAR 32.610.

C. Enforcing Government Claims-Collecting the Debt.

1. Collection methods.

- a. Voluntary Payment by the Contractor. After receiving the demand letter, the contractor may pay, arrange to defer payment, or arrange to make installment payments.
- b. Administrative Set-Off. If the disbursing officer is responsible for collection of a contract debt or is notified of the debt by the responsible official, and if the disbursing officer has contractor invoices on hand for payment by the government, the disbursing official shall make an appropriate set-off in the payment to the contractor. FAR 32.611.
- c. Withholding. If the contractor fails to make payment within 30 days of a demand, and has failed to request deferment, the government shall immediately initiate withholding of principal and interest. FAR 32.612.
- d. Tax Refund Offsets. 31 U.S.C. § 3720A authorizes the Internal Revenue Service (IRS) to collect certain past due and legally enforceable debts by offset against tax refunds. The DFAS-Denver Center is the single DOD manager and contact point for the IRS-DOD agreement for implementing and administering tax refund offsets. DOD Dir. 7000.14-R (Financial Management Regulation), vol. 10, para. 180403B.

2. Deferment of Collection. FAR 32.613.

- a. If the contractor is not appealing the debt, the government and the contractor may agree to a debt deferment or installment payments if the contractor is unable to pay in full at once or if the contractor's operations under national defense contracts would be seriously impaired. FAR 32.613(f).
- b. If the contractor is appealing the debt, suspension or delay of the collection action is not required. However, the responsible official shall consider whether deferment of the debt is advisable to avoid possible overcollection. FAR 32.613(d).

- c. Deferment pending disposition of appeal may be granted when the contractor is a small business concern or is financially weak. FAR 32.613(e).
- d. The government grants deferments pursuant to a written agreement. FAR 32.613(h) specifies the necessary terms. According to FAR 32.613(i), if the contractor's appeal of the debt determination is pending when it requests deferment, any deferment/installment agreement must provide that the contractor will:
  - (1) prosecute the appeal diligently; and
  - (2) pay the debt in full when the appeal is decided or the parties agree on the debt amount.
- e. The filing of an action under the contract's Disputes clause shall not suspend or delay collection of government claims. To obtain deferment of a debt determination that has been appealed under the Disputes clause, the contractor must present a bond or other collateral in the amount of the claim to the government. FAR 32.613(l).

D. Compromise Actions.

- 1. For debts under \$100,000 (excluding interest), if further collection is not practicable or would cost more than the amount of the recovery, the agency may compromise the debt or terminate or suspend further collection action. FAR 32.616.
- 2. For debts over \$100,000, DFAS must forward the debt to the Department of Justice (DOJ) for further action. If DOJ determines that the debt is uncollectible, it must notify DFAS that the debt should be written off. DOD Dir. 7000.14-R (Financial Management Regulation), vol. 10, para. 180201C.



E. Funds Received from the Contractor.

1. Miscellaneous Receipts Statute (MRS). 31 U.S.C. § 3302(b). Most funds received from a source outside the appropriations process must be deposited in the general fund of the United States Treasury.
2. Exceptions. Exceptions to the MRS are scattered throughout the United States Code and public law.
3. For more on the MRS and its exceptions, see General Accounting Office, Principles of Federal Appropriations Law, vol. II, ch. 6, § E (2d Ed. 1992); Major Timothy D. Matheny, Go On, Take the Money and Run: Understanding the Miscellaneous Receipts Statute and Its Exceptions, ARMY LAW., Sep. 1997, at 31.

**IX. CONCLUSION.**

